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BEFORE THE ARIZONA CORPORATION COMMISSION

JIM IRVIN
COMMISSIONER-CHAIRMAN
RENZ D. JENNINGS
COMMISSIONER
CARL J. KUNASEK
COMMISSIONER

IN THE MATTER OF THE COMPETITION IN THE PROVISION OF ELECTRIC SERVICES THROUGHOUT THE STATE OF ARIZONA

DOCKET NO. U-0000-94-165

NOTICE OF FILING

Carl W. Dabelstein hereby provides notice of filing of his direct testimony as required by the Commission's Third Amended Procedural Order, dated the 5th day of January, 1998, in the above-referenced docket.

RESPECTFULLY SUBMITTED this 21ST day of January, 1998.

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JAN 21 1998

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RENZ D. JENNINGS
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COMMISSIONER

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|---|---|
| IN THE MATTER OF THE COMPETITION IN THE PROVISION OF ELECTRIC SERVICES THROUGHOUT THE STATE OF ARIZONA ) | DOCKET NO. U-0000-94-165 |

DIRECT TESTIMONY

OF

CARL W. DABELSTEIN, CPA

January 21, 1998

TESTIMONY OF CARL W. DABELSTEIN

SUMMARY OF KEY POINTS

1. The Rules are ambiguous and lack the specificity necessary to properly address stranded costs. They should provide for the recovery of stranded costs, whether or not recorded on the affected utilities' balance sheets. They should be amended to specify the types of stranded costs allowed for recovery, the appropriate calculation period and method, and the time period and mechanism for recovery.

2. The entire stranded cost issue must be resolved <u>prior</u> to the beginning of retail competition. This proceeding and the companies' anticipated stranded costs filings should proceed as rapidly and diligently as possible, in order to meet the existing January 1, 1999 commencement date.

3. Costs that may be considered as stranded include capital and operating costs associated with generation assets, purchased power agreements, fuel and related transportation contracts and regulatory assets.

4. Utilities bear a strong burden of proof with respect to the justification for inclusion of the costs they consider to be stranded, and for which recovery is sought.

5. The most appropriate method for quantifying stranded costs is the "Net Revenues Lost" approach.

6. In computing stranded costs, it is critical to consider the expected remaining service lives and cost recovery periods associated with such assets that have been reflected in the ratemaking process.

7. Stranded costs should be recoverable over a period ranging from five to ten years.

8. The introduction of retail competition is intended to benefit all customers; therefore, all customers should bear some responsibility for stranded costs.

9. There is tremendous uncertainty associated with the process of estimating stranded costs. A mandatory, periodic true-up should be required by the Rules.

10. Parties advocating price caps and rate freezes should be required to provide definitive details of their proposals.

11. Utilities have a clear obligation to take all reasonable and necessary measures to mitigate their stranded costs. Mitigation can be achieved through cost reduction, revenue enhancement, or delaying the introduction of competition. Mitigation efforts should be evaluated on a company-specific basis.

TESTIMONY OF CARL W. DABELSTEIN

SUMMARY OF KEY POINTS

(CONTINUED)

12. Stranded costs have significant accounting and income tax implications. Any inquiry into stranded costs must consider all relevant accounting tax issues.

13. Parties advocating less than full stranded cost recovery should be required to provide detailed justification for their recommendations.

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Introduction

Q. Please state your name and address.

A. My name is Carl W. Dabelstein. My address is 2211 East Edna Avenue, Phoenix, Arizona 85022.

Q. In what capacity are you appearing in this evidentiary proceeding?

A. I am testifying as a consumer of electricity, served by Arizona Public Service Company.

Q. Please state your professional qualifications.

A. A description of my education and professional experience is attached hereto as Appendix A.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to provide input to this very important inquiry into the stranded costs that will likely occur with the introduction of retail competition into the electric utility business in the State of Arizona. Specifically, I will address the various key issues identified by the Chief Hearing Officer in his Procedural Orders recently issued in this Docket. I will then address several additional matters that I believe warrant the Commission's consideration in this most important aspect of electric industry restructuring. As a consumer, I want the benefits of new technology to be realized and to see the price of electricity reduced; however, for retail electric competition to be successful in the long run, it must be implemented in a rational, equitable and economically efficient manner.

Q. What has been your experience with respect to deregulation and competition in the public utility industry?

A. I have spent considerable time during the past fifteen years observing and assessing the effects of deregulation and the introduction of competition into segments of the public utility business that has been traditionally conducted exclusively by regulated monopolies.

Specifically, as more fully described in the accompanying Appendix A, I spent almost the entire decade of the 1980s as a regulatory consultant, serving a clientele comprised of both utilities and regulatory agencies. In connection therewith, a substantial portion of my time was consumed in identifying and assessing the effects of competition in both the terminal equipment and long distance markets in the telecommunications industry. During the latter part of the 1980s and early years of this decade, my focus turned to the effects of FERC activities deregulating segments of the natural gas pipeline business, such as through its issuance of Order Nos. 500 and 636. Finally, for most of this decade I have been involved in activities associated with the introduction of retail competition in the electric industry, both on a national and regional level. From 1993 through 1995, I participated in electric restructuring activities in the States of Wisconsin, Minnesota, and North Dakota. Also during that period, I served on the committee established by the Edison Electric Institute to address the stranded cost and accounting implications of the FERC MegaNOPR that became Order No. 888. For the past two years, I have been an active observer of the electric restructuring activities here in Arizona, most recently as Director of the Utilities Division of the Arizona Corporation Commission. In that capacity I coordinated the efforts of five of the six working groups created to address key restructuring issues. I also authored the report containing recommendations of the Working Group and Utilities Division Staff with respect to stranded costs that was submitted to the Commission in early October.

## Electric Competition Rules

Q. Do the Electric Competition Rules consider stranded costs?

A. Yes they do. Section R14-2-1601 includes a definition of stranded costs. Section R14-2-1607 addresses the Recovery of Stranded Costs. It provides for the recovery of unmitigated stranded costs, directs the creation of a special working group to address and report on a variety of stranded cost issues, and contemplates the filing of stranded cost estimates by the affected utilities. It also limits the charging for stranded costs to only those customers purchasing power in the competitive market.

Q. Do you believe the Electric Competition Rules are adequate and provide the proper guidance with respect to stranded costs?

A. No, I do not. They are a starting point, but contain some ambiguities and lack the degree of specificity that I feel is necessary to properly address the stranded cost issue in a reasonable, equitable and timely fashion. All ambiguities should be eliminated and the Rules should be sufficiently comprehensive to minimize opportunities for differing interpretation and/or application.

Q. Please describe the ambiguities that you believe exist in the Rules.

A. First, it is unclear whether the definition of stranded costs would cover unrecorded assets and liabilities. Due to certain requirements under Generally Accepted Accounting Principles, the affected utilities likely have certain stranded costs that do not appear as recorded assets and liabilities in their published financial statements. Some examples are the generation portion of the transitional obligation for postemployment healthcare benefits under Statement of Financial Accounting Standards No. 106, and amounts that may have been ordered by this Commission to be deferred for ratemaking, but which may not be reported under Generally Accepted Accounting Principles as regulatory assets by the respective utilities. There also may be unrecorded obiligations such as those relating to long-term fuel and transportation contracts. The affected utilities should be permitted to request the opportunity to recover all unmitigated stranded costs, whether or not presently reported as assets and liabilities in their balance sheets.

Another ambiguity that exists in the Rules is that with respect to the manner in which the costs of disposing spent nuclear fuel should be considered for recovery purposes. Section R14-2-1608 permits the costs of nuclear power plant decommissioning programs to be included in the System Benefits Charge; however, nowhere in the Rules is the cost of spent nuclear fuel disposal addressed. The Rules should be clarified to identify whether spent fuel costs are part of stranded costs, or should be treated in the same manner as the costs of nuclear decommissioning.

Q. With respect to stranded costs, what specificity do you believe needs to be included in the Rules?

A. In order to avoid significant differences between the affected utilities, I believe that some standardization is desirable. The types of costs that may be considered as stranded, as well as the calculation period and method used for quantifying stranded costs, should be identified. Moreover, the time period and mechanism to be used for stranded cost recovery should be set forth in the Rules.

## Timing of <u>Stranded Cost Filings</u>

Q. When should the affected utilities be required to file the estimates of their stranded costs?

A. Although the Rules do require the affected utilities to file estimates of their stranded costs, they are silent with respect to the timing of such filings. It is patently obvious that, if the transition to retail competition is to commence and proceed in a rational, efficient, and timely manner, the entire stranded costs issue, including their identification, quantification, and timing and method of recovery must be resolved as soon as practical. The affected utilities need to have sufficeint guidance from the Rules to begin preparing their stranded cost estimates and filings. Then, the Commission Staff and all interested parties need to have adequate time to thoroughly analyze and object to, if necessary, the companies' requests. All of this takes time, and it must be completed prior to the commencement of retail competition, now scheduled for January 1, 1999. Time is of the essence. This evidentiary proceeding and the required filings of stranded cost estimates should proceed as rapidly and diligently as possible.

Quantifying
<u>Stranded Costs</u>

Q. What costs should be included in stranded costs?

A. Any yet-to-be recovered, prudent operating or capital cost incurred by an affected utility under its traditional obligation to serve, that is likely unrecoverable in a competitive environment with prices reflecting marginal costs, will be stranded. Typically, this will include generation assets, purchased power agreements, fuel and related transportation contracts, and regulatory assets. Other costs may also be considered as stranded, depending on company-specific facts and circumstances. Generation assets are the single largest category of stranded costs. This includes net plant in service, construction work in progress, common plant associated with generation-related activities, fuel inventories and related transportation and handling facilities and equipment, and associated materials and supplies.

Potential stranded generating costs not only include the facilities' current recorded capital costs, but also the amounts that will be required to be expended in connection with their physical removal at the expected end of their respective service lives. Under the Rules, such costs associated with nuclear facilities are to be considered as recoverable under the System Benefits Charge. While clearly not as great, the costs of removing fossil plants at their retirement from service may nevertheless be substantial.

Regulatory assets represent current expenditures that have been deferred by the utilities and/or their regulators for future cost recovery. Such treatment is consistent with the long-standing principle followed by this Commission and other regulatory bodies in attempting to synchronize ratepayer benefit with cost recovery. Regulatory assets may also be created for moderating the rate impact of unavoidable or non-annually recurring events, or promoting utility involvement in public policy initiatives. Among the more common regulatory assets are: previously flowed-through deferred taxes, deferred fuel costs, deferred demand side management costs, deferred pensions and employee benefit costs, and extraordinary losses.

In all cases, I believe that an affected utility has a strong burden of proof with respect to identifying and quantifying stranded costs, and a clear obligation to take all reasonable steps for their mitigation.

Q. How may stranded costs be quantified?

A. Two predominant approaches exist for quantifying stranded costs. "Administrative" approaches essentially represent a process whereby a measure of stranded costs is established based on estimates and expectations of future market prices and asset values in a joint effort by the affected utility, the regulatory agency, and other interested parties. "Market Valuation" approaches use observed valuation of the stranded assets in a current market context. The most frequent administrative approach currently being used is the "Net Revenues Lost" method. The most frequent market valuation method is through asset sales or the divestiture of assets. For reasons more fully covered later in my testimony, due to the tremendous uncertainty associated with projecting market prices for power and other key variables, I believe the risks of estimation associated with a single, up front market valuation of stranded assets are such that the method should not be considered for stranded cost quantification.

Q. Which method do you believe should be used to quantify stranded costs?

A. No method is without its faults or critics; however, all things considered, I believe the most appropriate method is the Net Revenue Lost approach, with some opportunity for periodic true-up. This is a top-down approach that compares the expected future annual revenue requirements for the affected utility's generation business under traditional cost-based regulation with the annual revenues expected to be recovered in a competitive generation market with prices based on marginal cost. It recognizes that utilities that made multiple investment decisions under the traditonal form of cost-of-service regulation expected to receive a revenue stream to cover the cost of such investments over their expected useful service lives. Under this scenario, stranded cost is measured as the net present value of the annual differences between expected revenues under a continuation of regulation and those likely to be received after the introduction of retail competition.

The Net Revenues Lost approach is the method by which the FERC, in its Order No. 888, has directed companies subject to its jurisdiction to quantify wholesale stranded costs. It considers all of an affected utility's generation costs under traditional techniques understood by regulators, utilities, and other usual participants in the ratemaking process. It allows the calculation to reflect both above-market and below-market assets and costs. It is a relatively simple mathematical calculation once relevant assumptions are known. It eliminates the need for an asset-by-asset determination and can also accommodate periodic true-up to reflect the effects of changes in market prices or other market assumptions.

Calculation
<u>Time Frame</u>

Q. Over what time frame should stranded costs be calculated?

A. The time period over which stranded costs are computed will affect their overall quantification. Under the traditional obligation to serve, utilities made significant long-term investments on behalf of their customers. Using very long planning horizons, companies undertook construction programs to assure there was sufficient and reliable capacity over long term. These costs were incurred by the respective utilities to fulfill their retail franchise obligations to serve customers directly with the understanding that competing entities would not provide direct retail service, and that there would be a fair opportunity to recover the prudent investments that had been made. Under traditional ratemaking, the costs of long-term investments were spread over their estimated useful service lives, with the intent of properly synchronizing cost recovery with ratepayer benefit. In connection therewith, there was a reasonable expectation that utilities would be given a fair opportunity to recover all such capital costs. In order to correctly compute stranded costs, it is critical to consider the expected remaining service and cost recovery periods that are associated with such assets and that have been reflected in the ratemaking process. Imposing some limit on the period for quantifying stranded costs may not only deny the affected utilities a reasonable opportunity for full cost recovery, but may also deny ratepayers the potential benefits of recognizing the declining net rate base investments occurring over time. Accordingly, it is my belief that, in quantifying stranded costs, the remaining service lives of the affected assets implicit in rates be considered.

Recovery
<u>Time Frame</u>

Q. Over what period should stranded costs be recovered?

A. In addressing this issue, it is assumed that, unlike wholesale stranded costs which are recovered via an exit fee to departing customers, retail stranded costs will be recovered through an on-going wires charge. The length of the recovery period is primarily a function of the size of the stranded investment to be recovered, the number of parties from whom it will be recovered, and the extent to which the parties are interested in concluding the transition period as rapidly as possible. Basically, the longer the recovery period, the smaller the periodic charge but the greater uncertainty and delay until retail competition is fully achieved. Conversely, the shorter the recovery period, the greater the charge, but also the greater liklihood of recovery and more rapid completion of the transition to full retail competition. Whatever, the recovery period ultimately determined as appropriate by this Commission, it should be sufficiently long to provide the affected utilities a reasonable opportunity to recover their stranded costs.

The other states addressing stranded cost recovery in connection with electric industry restructuring have established recovery periods generally ranging from five to ten years. Considering all relevant factors, I recommend a recovery period of ten years, but would not be strongly opposed to a period as short as five years.

Stranded Cost
Payment Responsibility

Q. From whom should stranded costs be recovered?

A. Among the critical elements of any stranded cost recovery plan are the parties to whom such charges will be levied and the type of charge mechanism to be used. As stated, in their present form, the Electric Competition Rules provide for stranded cost recovery only from those utility customers taking competitive power (R14-2-1607.J). No specific guidance is given for the type of charge to be used for stranded cost recovery. Rule R14-2-1607.H permits an affected utility to request Commission approval of "distribution charges or other means of recovering unmitigated stranded costs from customers..." I believe all customers should bear some responsibility for stranded costs and that the proper recovery mechanism is a non-bypassable, across-the-board, end user wires charge that reflects the true nature of underlying stranded costs. I would not object, however, to some distinction being made between the stranded cost charge to be assessed the parties using competitive power, and those customers remaining as standard offer customers, recognizing that the latter are already paying stranded costs through their service rates.

Q. Why do you believe that all customers should bear some stranded cost responsibility?

A. I believe that all customers should bear some responsibility for stranded costs for two reasons. First, the major driver for the move to implement retail competition is lower rates for everyone in the long run. Electric restructuring is perceived to bring overall benefits to society in general, through improved efficiency in the industry and prices that more closely reflect true marginal costs. If it is truly believed that <u>all</u> consumers will ultimately benefit from the introduction of retail competition, then all consumers should bear some responsibility for stranded costs. This theory is consistent with the manner in which responsibility for stranded costs was spread in the deregulation of the natural gas pipeline industry, and is the way that certain portions of the costs of the local telephone loop plant, previously assigned to the interstate jurisdiction prior to deregulation of the long distance telecommunications business, are now recovered via subscriber line charges assessed to all end users, irrespective of whether they initiate or receive any long distance calls. This approach is also used in the property tax mechanisms in many states whereby some portion of all citizens' tax payments support the public schools, whether or not the taxpayers actually have or have had children attending school. The perceived overall benefit of free public education to society in general warrants such broad-based cost support.

I also believe that stranded costs should be recovered from all consumers for economic reasons. Those customers opting to procure competitive power may not see some or all of the benefits of competition in their final electric bills, if they bear the entire burden for stranded costs. To the extent that stranded costs are fully recoverable, and the period for their recovery is shorter than the horizon over which they were quantified, and recovery is permitted only from parties taking competitive power, the amounts paid by the latter, including the stranded cost charge, may actually exceed amounts paid by standard offer customers paying regulated rates with no additional stranded cost obligation. For example, assume a host utility has a bundled rate of 10 cents per kWh, comprised of 5 cents for generation and 5 cents for delivery. Further assume that competitive power is available for 3 cents per kWh. To the extent that the applicable stranded cost charge is greater than the 2 cent differential between the power cost of the host utility and competitive power, there is no economic incentive for the customers of the host utility to take the competitive power. The alternative source price per kWh (3 cents generation + 5 cents delivery + the stranded cost charge) would exceed the 10 cent price currently avalilable. A key reason why this may occur is illustrated by the simple example of an 8 percent $100,000 mortgage loan. With a thirty-year term, the monthly payment is $734. That increases to $956 when the term is reduced to fifteen years. With any cost recovery scenario, as the period for recovery is shortened, and all other factors held constant, the annual recovery amount will always increase.

To the extent that consumers of competitive power will not be able to realize the full economic benefit of changing power suppliers, there will be an economic disincentive to leave their host utility. True competition can only occur at the margin. Whatever ultimately may be the stranded cost mechanism approved by this Commission, it is critical that it be designed to promote efficient competition, meaning that all suppliers must compete on the basis of their marginal costs, and such supplier differences be reflected in the prices paid by consumers. It is clear that the true benefits of retail competition can only be realized if all consumers are required to participate in stranded cost recovery. It is apparent that R14-2-1607.J must be amended to broaden the base for stranded cost recovery to include all consumers for whom utilities made long-term commitments in connection with the traditional obligation to serve.

Q. Should new customers bear an obligation for stranded costs?

A. Yes, I believe they should. They should pay their fair share as though they had been served all along. The affected utilities have traditionally planned their systems to accommodate customer growth. Moreover, an incentive should not be created for customers to attempt to bypass stranded cost obligations by trying to appear as though they are a "new" customer.

Q. Should departing customers be charged for stranded costs?

A. To the extent they are truly physically leaving the area served by the host utility, they should bear no further stranded costs. Effects of routine customer departures have traditionally been considered in utilities' generation planning processes. The impact of such departures will, to a certain extent, be offset by new customers of the utility who will assume their respective share of stranded costs. Moreover, the departing customers will likely be subject to stranded cost charges by the incumbent utility in the new area to which they relocate.

Q. What about customers that opt to self-generate?

A. R14-2-1607.J states that reductions of electricity sales due to customers self-generating shall not be used to calculate or recover stranded costs. I believe that the Rule should be amended to require some stranded cost compensation from those customers who decide in the future to self-generate. Self-generation may be a way some parties choose to bypass their stranded cost responsibility. It could also lead to economically perverse results. If, for example, the host utility has marginal costs of 4 cents per kWh and a stranded charge of 5 cents per kWh, the customers may opt to self-generate at a marginal cost of 7 cents--3 cents above the utility's marginal cost. That type of uneconomic bypass would result in an overall efficiency loss. To eliminate any incentive for stranded cost bypass, the charge should be made recoverable from all customers, including those that elect self-generation.

There are two ways that may be used for collecting stranded costs from customers opting to self-generate. First, many such customers will continue to purchase emergency, back-up power from the host utility. In such circumstances, the customer's allocated share of stranded costs could be incorporated as part of the standby service charge. Second, it may be possible to recover stranded costs from customers that depart to self-generate through some form of exit fee.

Q. Should those parties currently served under interruptible rates and special contracts be obligated to compensate their host utility for some portion of the stranded costs?

A. These customers present an interesting situation. By definition, interruptible customers go off-line at times of high system demand. They are billed under rates based upon the full cost of service, less some credit to represent the higher peaking capacity costs the utility avoids when such customers' service is suspended. With respect to the special contract customers, under this Commission's current policy, such customers must have economically viable power supply alternatives. By signing the special contracts, they agree to remain with their host utility, and benefit by receiving certain rate concessions. Their special rates reflect all variable costs, plus some contribution toward fixed costs. Other customers benefit as well, by not having their rates increase to cover the lost margins that would result due to customer departures, absent such agreements. Clearly, the stranded cost implications for interruptible and special contract customers are different from those of full service, firm customers.

I believe that a distinction should be made with respect to interruptible customers such that they bear somewhat reduced stranded cost charges, depending on the specific manner in which the costs of serving such customers are determined and reflected in the resulting rates. Utility generation capacity planning and service requirements for this class of customer are less than those associated with firm service customers. As a result their stranded cost burden for capacity-related costs should be less. On the other hand, I do believe that interruptible customers should be assigned full responsibility for energy-related stranded costs.

With respect to special contract customers, it is my belief that they should, as a group, be assigned their fair share of the stranded cost burden, but the ultimate recovery thereof should be a matter for negotiation between the respective parties. The remaining body of ratepayers should not be burdened with any portion of the stranded costs allocable to, but not recoverable from, this group of customers.

Q. For purposes of developing a stranded cost charge mechanism, on what basis should costs be allocated between regulatory jurisdictions and between customer classes?

A. Stranded costs should be allocated jurisdictionally and to customer classes in a manner consistent with the respective utility's current ratemaking treatment of the actual costs themselves. This should affect a recovery of stranded costs in relatively the same proportions as cost recovery would have been expected to be achieved under a continuation of regulation. This appraoch to allocation has been adopted by several of the states considering electric restructuring.

Q. What mechanism should be used for billing and recovering stranded costs?

A. I believe the most appropriate mechanism for billing and recovering stranded costs is a non-bypassable, across-the-board end user wires charge with both energy and demand components. This is consistent with sound economic principles and reflects the underlying nature of the stranded costs.

True-up of
<u>Stranded Cost Estimates</u>

Q. Should there be a periodic true-up of the utilities' estimates of stranded costs?

A. Yes, there most certainly should be a periodic reexamination of administratively determined stranded costs. Presently, the Electric Competition Rules provide for the possibility of such reconsideration. R14-2-1607.L states that the Commission may order regular revisions to the estimates. I believe the Rules should be amended to <u>require</u> periodic true-ups and corresponding revisions to the stranded cost charges throughout the recovery period. While the calculation methodology and estimates of stranded costs could be agreed upon before retail competition begins, the actual calculations and associated charges would be determined on a periodic basis reflecting realizations of the relevant variables. Initially, this could be annually, but as experience and confidence in the quantification process is gained, the frequency could be extended.

Q. Why do you believe there should be a periodic true-up?

A. There is considerable uncertainty in attempting to quantify stranded costs. The process is based on a number of factors that, at this point, are nearly impossible to predict. It is pure speculation to project what the markets and prices for power will be in the future. To the extent estimates of stranded costs are overstated, utility shareholders will be unjustly enriched and consumers will be economically detrimented. If the quantifications are understated, the opposite effects on these stakeholders will occur.

Clearly, the most significant variable in quantifying stranded costs is the market clearing price for power. It is implicit in every computational methodology, both administrative and market-based. It is based on a variety of factors including customer demand, market structure, new accounting and tax rules, generation and fuel mix, generation and transmission capacity, the level of interest rates and inflation, advances in technology, and new laws and governmental regulations. At this point, trying to forecast the market price for power over the stranded cost calculation horizon would probably be as much as or more difficult than trying to guess the price of a single stock on the New York Stock Exchange throughout that same period. An example of the risks in trying to estimate the prices and costs of electricity can be seen in the problems encountered in New York and California as the regulators in those states made determinations and rulings in connection with QF power under the requirements of PURPA. Many of the stranded costs of electric utilities in those states can be attributed to such errors in estimation.

I believe that a periodic true-up is necessary to assure that electric restructuring in Arizona is carried out in a manner that protects the public interest. Such a revisiting does not have to guarantee a dollar-for-dollar recovery (regulation never did that), but at a minimum should enable prospective adjustments of the stranded cost charge to reflect changes in major uncontrollable variables, for the protection of both consumers and utility investors.

Price Caps
and Rate Freezes

Q. Should price caps and rate freezes be a part of the stranded cost recovery program?

A. Although I am aware that other states addressing retail electric competition are considering price caps and rate freezes as a part of their overall plan, I am taking no specific position on whether this Commission should adopt them for Arizona. However, I do wish to comment on the matter.

In the Stranded Cost Working Group meetings, several of the participants stated their preference for a price cap or rate freeze. No one, however, offered any substantive details as to how such a plan should be developed, implemented, or operated. For example, what rates should be frozen or capped--the total price for service, or just the distribution portion? In the competitive environment, generation will be deregulated, transmission will essentially be totally FERC-regulated, leaving only distribution service for the ACC to regulate. Does the Commission have the continuing authority to include generation and transmission service in a price cap or rate freeze if they no longer regulate those business segments? Does a price cap or rate freeze comport with the Commission's responsibility to provide utilities under its jurisdiction a reasonable opportunity to recover the cost of providing service. I believe that any party advocating price caps or rate freezes should be required to answer these and other questions and supply all of the relevant details of their proposal.

Mitigation of
Stranded Costs

Q. What do the Rules say about mitigation of stranded costs?

A. R14-2-1607.A requires the utilities to take every feasable, cost-effective measure to mitigate stranded costs, and cites expanding markets or the scope of their service offerings as examples of mitigation techniques. I totally agree.

Q. What factors should be considered for the mitigation of stranded costs?

A. In considering mitigation, it is important to note that many stranded costs are obligations or sunk costs which, by definition, cannot be mitigated. They can only be reallocated, or offset by additional revenues. Accordingly, many mitigation proposals are merely targeted to shift the cost responsibility between utility investors, consumers, taxpayers, wheeling customers, or independent power producers. As a result, not all mitigation strategies being advanced are necessarily based on considerations of fairness or equity when the ultimate bearer of this financial responsibility is identified.

Mitigation can be achieved in two principal ways: cost reduction and containment efforts and revenue enhancement strategies. Mitigation can occur when affected utilities reduce generation and operating costs to be more in line with those of the market. This may be accomplished by reducing operating costs (both labor and non-labor) via productivity and efficiency gains, and by repowering or retrofitting existing plants and replacing inefficient generating units and equipment as well as making changes that facilitate fuel switching. Another mitigation tool available is the renegotiation or buy-out of above market, or otherwise uneconomic, fuel, transportation, or purchased power contracts.

Stranded cost mitigation may also occur when affected utilities are able to generate additional revenue sources. Such efforts may include the development of new energy sales opportunities at prices above the respective utility's actual variable fuel and O&M costs, the sale of existing owned capacity and purchased capacity rights, and the sale of emmission (SO2 and NOx) credits. Utilities with substantial transmission capacity will find marketing to be a more effective strategy than will utilities without such interconnection possibilities.

I believe an important distinction must be made with respect to revenue enhancement as a mitigation tool. To the extent that additional revenues are derived from the generation assets or other resources which underlie the revenue requirements upon which current regulated rates are based, they may be considered as being available for mitigating stranded costs. Revenues derived from assets and other resources that are currently non-jurisdictional or non-utility, and for which the utility shareholders are at risk, should not be used as an offset to stranded costs.

A third way that stranded costs may be mitigated is through accelerated depreciation of generation assets or accelerated amortization of regulatory assets. Unless, however such accelerated expense recognition is accompanied by commensurate cost recovery, this exercise is not mitigation, it is merely a transfer of wealth from utility investors to consumers. A way for this technique to achieve true mitigation is through the use of some type of rate freeze (such as has been done with nuclear assets in California) or a negotiated earnings sharing agreement between an affected utility and its regulators (similar to that which exists between APS and the ACC). In either case, overall costs of service may be declining and a portion of the savings are offset by the accelerated expense recognition rather than flowing the savings in their entirety back to ratepayers.

The stranded cost burden can also be reduced through time. By delaying the introduction of competition, the utilities will be able to continue recovering all of their stranded costs through bundled full service rates. As capital investments in generation assets continue to be recovered through depreciation charges, there will be a reduced, yet-to-be recovered amount at the time competition is ultimately introduced. I mention this for information purposes only; it is not my recommendation to change the scheduled January 1, 1999 implementation date. I would, however, not be opposed to such a postponement if it would mean a more efficient and equitable move toward competition.

As stated, I strongly believe that the affected utilities have an obligation to take every reasonable measure to mitigate stranded costs. However, because the circumstances of what constitutes reasonable and prudent mitigation efforts can be expected to vary widely between companies, a generic approach for analysis should be avoided. Mitigation efforts should be evaluated on a case-by-case basis. It is also important to note that mitigation efforts themselves are not without costs; they may generate additional stranded costs. Therefore, I believe the Electric Competition Rules should be amended to permit each affected utility to independently demonstrate that their mitigation efforts were reasonable and cost beneficial, based on all relevant facts and circumstances. In addition, amounts prudently spent in connection with mitigation efforts should be included in the balance of recoverable stranded costs.

Source of the
Market Clearing Price

Q. How should the market clearing price be determined?

A. As stated the market clearing price for power is the most critical and sensitive variable used in computing stranded costs. Other states are using various measures for the market price. As California begins its foray into retail electric competition, the utilities in that State will use 2.4 cents per kWh as the intitial market price for computing stranded costs in 1998. That represents the estimated short-run avoided costs for the year and will be trued-up at a later date. Ultimately the price on the spot market known as the California Power Exchange will be used once that market is firmly established. In Michigan, the utilities will use an averavge price based on regional cost data from the Michigan Electric Coordinated System. Such price estimates are required to be trued up annually.

One likely source of a market price available for Arizona is the Dow Jones Palo Verde Electricity Index. I believe, however, that such an index may not be totally reliable for the long run. Factors such as substantial excess generating capacity in the Southwest and effects of new participants trying to establish a foothold in the market may produce pricing trends that may be unrepresentative and and likely unsustainable in the long run.

In establishing a market clearing price for purposes of quantifying stranded costs in Arizona, a key consideration is whether an ex post make-whole adjustment to actual is part of any true-up process. While a total make-whole process may be inappropriate (regulation provided only an opportunity to recover all costs, not a guarantee) due to the extreme difficulty in projecting the market clearing price, I believe that strong consideration should be given to adjusting stranded cost recovery to eliminate the effects of errors in estimating the market clearing price. To the extent such an adjustment is allowed, the actual market price could be determined by summing all electric revenues for capacity and energy in Arizona during the measurement period, and dividing the result by actual kWh sales during that same time frame.

Accounting Issues

Q. Does the issue of stranded cost quantification and recovery raise any significant accounting implications.

A. Industry restructuring and the stranded costs likely to result therefrom have significant accounting implications.

Q. What are the accounting implications?

A. An assessment of the accounting implications associated with stranded costs must first begin with an understanding of the unique nature of accounting principles and practices used in the public utility industry. In most instances, the same accounting principles that apply to businesses in general also apply to public utilities. The differences that exist, however, are significant and are totally attributable to the traditional process whereby utility rates are based on the costs of providing service. By having the power to determine the costs upon which rates are based, regulators can create economic impacts that must be appropriately considered in utility accounting and financial reporting. The accounting used by utilities has evolved over the years, and gained widespread acceptance by accounting standards setters, governmental agencies, regulators, and the financial community.

The key accounting standard affecting utilities is Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation," ("SFAS No. 71"), which defines a regulated entity and contains standards that must be complied with in preparing financial statements issued by public utilities. All of the affected utilities in this proceeding keep their books in accordance with SFAS No. 71.

Under SFAS No. 71, the most important difference between the accounting used by regulated utilities and unregulated businesses is the ability of regulators to create assets ("regulatory assets") by deferring to future periods (and therefore recoverable in future rates) costs which would otherwise be charged to expense in the current period. With their legal authority to identify the types and amounts of costs to be recoverable in rates, regulators have traditionally been able to provide the necessary level of assurance through rate orders that any amounts ordered to be deferred for ratemaking purposes meet the criteria to be reported as assets in published financial statements. Many of the stranded costs of utilities are such regulatory assets.

Other utility industry specific accounting standards have been issued by the Financial Accounting Standards Board ("FASB") in response to concerns over the financial implications of non-traditional ratemaking practices. SFAS No. 90, issued in 1986, addressed the proper accounting for costs associated with cancelled power plant projects, while SFAS No. 92, issued in 1987, dealt with accounting for plant costs deferred for future rate recovery under commission-approved phase-in plans.

With the emergence of competition and deregulation in the utility industry, many of the companies discovered they no longer met the criteria set forth in SFAS No. 71 to continue to be characterized as a "regulated enterprise" for accounting purposes. In response thereto, in 1988 the FASB issued SFAS No. 101, "Accounting for Discontinuation of Application of SFAS No. 71." The thrust of this new standard is that, when an enterprise ceases to meet the criteria of SFAS No. 71, it must discontinue its application, and remove from its books of account the effects of actions by regulators that would not have been recorded by enterprises in general. Typically, that means writing off all recorded regulatory assets and liabilities.

In 1995, an additional accounting standard having stranded cost implications was issued by the FASB. SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" addressed concerns that arose within the accounting profession and in the financial community, particularly with respect to reported assets of utilities, given the extent to which deregulation and restructuring was occurring in the industry. SFAS No. 121 lists certain events (including a significant change in the regulatory climate in which a company operates), the occurrence of which requires the company to consider whether any of its assets may have been impaired. For this purpose, the carrying amount of the affected asset must be compared to the expected future undiscounted value of related net cash flows. If the recorded amount exceeds the projected cash flows, then asset impairment must be recognized and the book value of the asset reduced to its fair market value.

Any inquiry into stranded costs quantification and recovery must consider the requirements and effects of SFAS No. 71, 101, and 121. The major potential threat to the affected utilities of being forced to go off of SFAS No. 71 would be that they immediately write-off all generation-related regulatory assets. Then, to the extent that the generating assets are impaired, further write-offs would be required under SFAS No. 121.

As the electric utility restructuring efforts proceed, it has become patently obvious that, as written, SFAS No. 71 did not fully contemplate the direction that deregulation and competition are taking today. Notwithstanding the direction and guidance existing under SFAS No. 71, 90, 92, 101 and 121, there has been considerable uncertainty raised in connection with many of the restructuring plans being considered. Some of the questions being raised include:

a) When does a utility go off SFAS No. 71-- upon the announcement of a date certain, or on that date certain?

b) May a stranded cost that would otherwise have to be written off under SFAS Nos. 101 or 121, continue to be reported as an asset if its recovery will be allowed as part of billings for distribution service?

In May 1997, the Emerging Issues Task Force of the FASB agreed to consider these issues as part of an inquiry into entities facing deregulation, specifically, the three major electric utilities in California. In August, EITF 97-4 concluded that companies should discontinue using SFAS No. 71 for business segments when legislation or a regulatory decision is issued that contains sufficient detail to reasonably determine how a transition plan will affect the deregulated portion of the business. In addition, it concluded that regulatory assets and liabilities may remain on the regulated books of account if they will be collected through cash flows (i.e. stranded cost charges) of the business segments continuing to be regulated.

At this point, I believe the Electric Competition Rules lack the specificity that would require the affected utilities to discontinue following SFAS No. 71. Sufficient support exists through EITF 97-4. I do believe, however, that as soon as the Rules contain sufficient information for utilities to make the required assessments of deregulation as contemplated under EITF 97-4 (perhaps when they are amended as a result of this evidentiary proceeding) the companies will have to go off of SFAS No. 71. I have discussed this matter with and provided copies of the Rules and the report of the Stranded Cost Working Group to certain members of the AICPA Public Utility Committee and the NARUC Subcommittee on Accounts and all concur with my assessment.

Based on the foregoing, the potential adverse impact on the affected utilities of less than a full opportunity to recover their stranded costs is obvious. Not only do the Rules have to clearly provide that opportunity, but also should include specificity with respect to quantification methods and recovery mechanisms that provide the required degree of assurance of recovery necessary, in order to avoid the companies having to suffer significant write-offs against retained earnings, unnecessarily. Expanding the base from whom stranded costs will be recovered and including a periodic true-up mechanism are examples of ways to raise the degree of assurance of stranded cost recovery.

Q. Are there other stranded cost accounting issues?

A. Yes. There are several potential stranded cost accounting issues for which there exists little direction in the FASB accounting standards. Moreover, specific accounting guidance from the FERC with respect to the proper accounting for stranded costs or related revenues has been relatively sparce. For example, uncertainty exists with respect to the manner in which stranded cost recovery revenues may be applied to specific costs, and in the way that a generating plant should be depreciated when it is expected to be operated for its full remaining physical life, which is far in excess of the established stranded cost recovery period. Another unresolved issue is an on-going inquiry by the FASB into accounting for liabilities related to the closure or removal of long-lived assets. This is relevant to both nuclear decommissioning costs and costs of removing fossil plants at the end of their respective service lives.

I believe that the affected utilities should be required to include detailed descriptions of their proposed accounting for stranded costs and related revenues as part of their stranded cost estimates filed under R14-2-1607.G. Moreover, the true-up procedure I have previously advocated in this testimony would afford all parties an opportunity to address the effects of any new accounting rules or standards issued subsequent to the commencement of the transition period.

## Tax Issues

Q. Do stranded costs raise any tax issues?

A. Yes. The quantification and recovery of stranded costs create a number of significant tax issues. These include the manner in which any tax benefits previously "flowed through" in the ratemaking process and existing deferred tax reserves and unamortized investment tax credits may be considered in the process of quantifying stranded costs. In addition, a potentially significant issue exists with respect to the continuing ability of nuclear utilities to obtain a current income tax deduction for contributions made to external decommissioning trust funds.

Q. Please describe the "flow-through" issue.

A. In many instances certain revenues and expenses are treated differently for book (ratemaking) and tax purposes. Such differences may be characterized as either permanent differences or timing differences.

Permanent differences are revenues or expenses that are considered for either book or tax purposes, but not the other. Examples of permanent revenue differences include interest on municipal bonds and the equity component of AFDC, which are treated as income for book purposes, but not recognized for tax purposes, and contributions in aid of construction which are income for tax purposes only. Some permanent expense differences include lobbying expenses and portions of the costs of business meals and entertainment which are recorded expenses on the books, but are not allowed as tax deductions. Permanent differences affect only the current accounting period.

Timing differences occur when revenues and expenses are recognized in different accounting years for book and tax purposes. Over time, the differences completely reverse, and the cumulative effect on book and tax income is the same. For public utilities, the greatest timing difference is that which exists with respect to book and tax depreciation, with the latter reflecting accelerated methods and shorter lives. Under generally accepted accounting principles, deferred taxes must be recorded for the effect of all timing differences. Deferred income taxes offset the effect of the timing differences reflected in the calculation of the current income tax expense, thereby providing a levelizing effect on the <u>total</u> income tax expense. In ratemaking, the practice of including deferred income taxes in the cost of service is labeled "tax normalization." The inclusion of deferred taxes in the cost of service will initially increase the overall revenue requirement. As the timing differences reverse, the opposite will occur. Since deferred taxes are not allowed as tax deductions, there is a tax-on-tax effect associated with deferred taxes. Accordingly, with combined Federal-state tax rate of 40%, the effect of $1 of deferred taxes is $1.67 in revenues.

While generally accepted accounting requires deferred taxes to be recognized for <u>all</u> book-tax timing differences, that is not necessarily the case in utility ratemaking. Except for certain depreciation-related timing differences that the Internal Revenue Code and IRS Regulations require to be normalized, regulators have had the liberty to include in ratemaking only the deferred taxes they felt appropriate. In many instances, they did not allow deferred taxes to be recognized for some timing differences that produce larger current tax deductions, thereby lower income tax expense and correspondingly lower annual revenue requirements. When certain timing differences are considered in computing the income taxes in ratemaking, but deferred taxes are not allowed, the benefits of the timing differences are said to be "flowed-through" to ratepayers.

Because the effects of timing differences reverse over time, the tax benefits flowed through in the past in the form of lower utility service rates, will become greater tax liabilities and increased revenue requirements in the future. There is an implicit promise in the "flow-through" ratemaking methodology that, when the higher tax obligations arise in the future, the affected utility will be allowed to recover such increased costs in rates.

Over the years, the ACC has required most of the utilities under its jurisdiction, including all of the affected utilities in this proceeding that are tax-paying entities, to flow-through some tax benefits in ratemaking. The companies' ability to recover the higher future taxes that will result as the timing differences reverse, will disappear as soon as they are required to compete in a competitive market, and the Commission is no longer setting rates for the deregulated business segments. As I stated previously in this testimony, the affected utilities should be permitted to include in their stranded cost estimates all generation-related, previously flowed-through, but yet-to-be recovered, deferred taxes.

Q. Please explain the issue dealing with the use of deferred tax reserves and unamortized tax credits in the process of quantifying stranded costs.

A. As very capital-intensive entities, public utilities have received significant tax benefits through the use of accelerated tax depreciation and the investment tax credit. Accelerated depreciation enables taxpayers to depreciate assets for tax purposes more rapidly than for book purposes, thereby lowering tax liabilities in the early years of an asset's service life. The investment tax credit permitted taxpayers a permanent reduction in their tax liabilities, based on a percentage of amounts spent for the acquisition of certain classes of plant and equipment.

The intent of the Congress in creating the benefits of accelerated depreciation and the investment tax credit was to encourage taxpayers to make capital investments, thereby creating jobs and stimulating the economy, through both lower current income taxes or the permanent forgiveness of tax. In the early years of their existence, there were no ratemaking rules or restrictions placed on regulators, limiting or directing their treatment of such benefits in utility ratemaking. As a result, many regulators immediately flowed the benefits through to ratepayers in the form of lower service rates.

As the trend toward such "flow-through" expanded during the 1960s, the Congress became alarmed that it would thwart the purpose for which these benefits were created by depriving utilities tax of benefits available to other taxpayers, reducing Federal tax receipts due to the reductions in the utilities' gross revenues and taxable income, and failing to match fairly the tax benefits arising from capital asset expenditures to the ratepayers who actually bore the capital costs in rates. This resulted in the enactment of legislation now incorporated into the Internal Revenue Code and IRS Regulations that severely restrict the ability of regulators to flow-through tax benefits associated with accelerated depreciation and investment credit in utility ratemaking.

Deferred taxes associated with timing differences arising due to accelerated depreciation methods and shorter tax lives must be recognized in ratemaking. The deferred taxes must be included in tax expense, and the corresponding accumulated deferred tax reserve may either be deducted from rate base <u>or</u> reflected in capital structure at a zero cost for rate-of-return purposes. The ratemaking treatment afforded deferred taxes relating to any book-tax timing differences other than accelerated methods and shorter lives for depreciation are not covered by the IRS Rules of laws.

Utilities have traditionally accounted for the investment tax credit by deferring it on their balance sheets, and then amortized it as a reduction of income tax expense over the lives of the assets that gave rise to the credit. The IRS Rules and tax laws require a sharing of the credit. In connection therewith, utilities must elect either of two ratemaking options. Under Option No. 1, the unamortized balance of the credit is deducted from rate base, but the annual amortization amount is recorded "below-the-line," and may not be treated as a reduction of income tax expense for ratemaking. Under Option No. 2 (that which is most common in the utility industry), the amortization of investment tax credit is used to reduce income tax expense for ratemaking, but the unamortized balance is not deducted from rate base.

One issue arising in other states assessing retail electric competition, and one that could appear here, is the proper treatment of the deferred tax balances and unamortized tax credits in calculating stranded costs. I believe that such amounts may be considered as offsets to related stranded capital costs, but the Internal Revenue Code and IRS Rules clearly require that there must be a proper synchronization of these tax benefits with specific stranded costs to which they relate. To the extent any portion of the capital cost of a stranded asset is excluded in the calculation, there must be a corresponding reduction in the offset provided by the related tax benefits.

I base my opinion with respect to deferred tax reserves on the "consistency requirement" in Code Section 168 (i)(9)(B). It requires that a ratemaking authority (i.e. the A.C.C.) use an estimate or projection of a regulated company's income tax expense, depreciation expense, and balances of accumulated deferred taxes that are all consistently determined with respect to each other and with respect to rate base. A similar consistency requirement exists for investment tax credit in Code Section 46 (f)(10). Basically, these serve to limit regulators' ability to consider the deferred tax reserves and unamortized tax credits to the extent the related capital costs are considered.

Although I am not aware of any specific IRS guidance on this offset issue in dealing with stranded costs, during the past few years there have been a number of IRS Private Letter Rulings addressing the ability to consider offsets in other circumstances, such as with public utility phase-in plans, plant cost disallowances, and assets removed from the scope of regulation. In all instances, the IRS found that, when any such capital cost adjustment is made to regulated rate base, a corresponding adjustment must be made to the related tax benefits. Although technically, Private Letter Rulings may not be cited as precedents, they are nevertheless useful in showing the IRS position on certain issues. In addressing this position, the IRS has been totally consistent.

Q. What is the issue with respect to the tax deduction for nuclear decommissioning?

A. The costs of dismanteling and removing power plants at the end of their service lives are recovered as a component of book depreciation expense. For tax purposes, however, tax deductions for removal costs are generally only allowed when the removal is occurring and amounts being expended. The recovery of removal costs in rate revenues with no corresponding deduction for cost of removal accruals gives rise to higher current tax liabilities and creates a deferred tax asset during the years the asset is in service. Decommissioning expense is a type of removal cost, and also recovered in book expenses over the service life of the respective nuclear power plant. The principal difference is the significantly larger cost involved with nuclear plants.

The Tax Reform Act of 1986 added Section 468A to the Internal Revenue Code and provided utilities with nuclear plants an opportunity to obtain a current tax deduction for contributions made to external decommissioning trusts. Such deductions are limited to the lower of the Schedule of Ruling Amount ("SRA") or the applicable cost of service amount for the year. An SRA, required to be filed with and approved by the IRS annually, specifies the maximum annual payments allowed to be made to the decommissioning fund. It must be based on the same assumptions used by the applicable regulators in establishing the amount allowed for inclusion in cost of service for ratemaking.

Deregulation of the generation segment of the electricity business raises questions about the nuclear utilities' continuing ability to meet the requirements for the tax deductibility of payments to external decommissioning trusts. With the introduction of retail competition and resulting departure from cost of service ratemaking for such utilities, it is unclear whether they will continue to meet the conditions set forth in Internal Revenue Code Section 468A. For example, on what basis would an SRA be prepared? The inability of the utilities to deduct decommissioning fund deposits currently could have significant stranded cost implications.

Stranded Cost Recovery

Q. Are there any other issues you believe should be addressed?

A. Yes. Although I believe the Electric Competition Rules do contemplate and provide for the recovery of stranded costs, a number of the participants in the Stranded Cost Working Group expressed strong reservations against full or partial stranded cost recovery. Many felt there should be some sharing of the burden between ratepayers and shareholders, while others believed no stranded cost recovery should be allowed. None of the parties offered any substantive explanation or justification for requiring utility investors to assume any of the stranded costs. No one provided any evidence that utility investors have ever been compensated the higher risks of competition.

Q. Do you have a recommendation?

A. Yes I do. I believe that the affected utilities should be provided a reasonable opportunity to recover their stranded costs. They made the underlying investments and incurred in good faith the related obligations under a traditional obligation to serve that was intended to provide a business environment such that they had a reasonable expectation to recover the costs of providing safe, reliable, service. Stranded cost recovery should not, however, be automatic. The affected utilities have a strong burden of proof with respect to the assets and costs for which recovery is being requested. They must take all reasonable steps to mitigate their stranded costs and be prepared to demonstrate they have not already been compensated therefore in any way.

Q. Does this conclude your testimony?

A. Yes it does.

# PROFESSIONAL QUALIFICATIONS

Q. What is your educational background?

A. I graduated from the University of Nebraska with a Bachelor of Science Degree in Business Administration, major in Accounting. I also received a Master of Business Administration Degree, concentration in Finance from Rockhurst College in Kansas City, Missouri.

Q. What has been your professional experience?

A. Upon graduation from college in 1968, I was employed by the public accounting firm Arthur Andersen & Co. in its Omaha office. During such employment, I participated in and and directed audits and other engagements involving banks, healthcare facilities, public utilities, insurance carriers, and other clients.

In 1971, I accepted a position reporting to the controller at Central Telephone & Utilities Corporation at its then headquarters in Lincoln, Nebraska. During the five years I was employed by CTU, I directed such activities as financial and regulatory accounting and reporting, internal auditing, budgeting, corporate acquisitions and divestitures, rate case and other regulatory filings, banking relations, and corporate financings.

From 1976 to 1981, I was employed by Kansas City Power & Light Company. My responsibilities included the corporate audit function, operations budgeting, and rate case filings in Kansas and Missouri and with the Federal Energy

Regulatory Commission. During that period, I also served as a member of the Internal Control and Auditing Committee of the Missouri Valley Electric Association, and the Finance and Accounting Committee of the Standardized Nuclear Unit Power Plant System.

From 1981 to 1991, I was employed as a Senior Project Manager for a regulatory consulting firm and successor firm, directing rate case, management audit, and other engagements for a clientele that included utility companies, public service commissions, and intervenors to regulatory proceedings

From 1991 through 1996, I was employed as an internal consultant with Northern States Power Company in Minneapolis, Minnesota. My responsibilities included accounting, taxation, and cost allocation issues in rate cases and special regulatory proceedings, performing investment evaluations, accounting and tax research, developing cost recovery plans, and advising senior management in connection with the development of performance-based ratemaking proposals and strategic policies for competing in a competitive electric utility industry.

In late 1996, I accepted a position as the Tax Research Coordinator for Tucson Electric Power Company. My main responsibilities included tax research and planning, preparation and review of corporate tax returns, and meeting with representatives of tax authorities. I also directed the team charged with the responsibility for developing and implementing a system for strategic business unit reporting.

In January, 1997 I was appointed Director of Utilities for the Arizona Corporation Commission. In that capacity, I directed a staff of approximately ninety professional and clerical employees responsible for overseeing railroad and pipeline safety in Arizona and for regulating the water, telephone, electric, and natural gas distribution utilities in the State. I resigned from that position in December.

Q. What are your professional certificates and qualifications?

A. I hold Certified Public Accountant certificates issued by the Boards of Accountancy in Nebraska and Kansas. I am a member of the American Institute of Certified Public Accountants, the National Association of Railroad and Public Utility Tax Representatives, and the National Association of Radio and Telecommunications Engineers ("NARTE").

Q. What technical licenses do you hold?

A. I hold an Advanced Class FCC Radio License and a Technician Class II NARTE Certification with regulatory and antennas endorsements.

Q. What is your teaching experience?

A. I have developed and conducted seminars on a variety of topics for employees of public utilities and regulatory agencies. I have also taught classes on behalf of the

U.S. Telephone Association. I am presently a member of the faculty of the NARUC Regulatory Studies Program at the Public Utility Institute at Michigan State University. In connection with my teaching, I have written three training books: <u>Public Utility Income Taxation and Ratemaking</u>, <u>Public Utility Working Capital</u>, and <u>Generally Accepted Accounting Principles for Utilities</u>.

Q. What has been your experience in regulatory proceedings?

A. During the past twenty-five years, I have participated in numerous rate cases and other regulatory and litigation proceedings involving electric, gas transmission and distribution, telephone, water and wastewater utilities conducted in Alaska, Arizona, California, Colorado, Connecticut, District of Columbia, Florida, Indiana, Kansas, Maryland, Minnesota, Missouri, Nevada, New Mexico, North Carolina, North Dakota, South Dakota, Virginia, and Wisconsin, as well as the National Energy Board of Canada, and the Federal Energy Regulatory Commission. I have testified on matters involving financial and regulatory accounting, auditing, cost allocation, financial forecasts, capital and operations budgeting, taxation, corporate acquisitions, holding companies, valuation and transfer pricing, deregulation, the cost of capital, industry restructuring, and regulatory policy.

Q. In what proceedings have you testified before this Commission?

A. I have previously testified on behalf of the Commission

Staff in proceedings involving Tubac Valley Water Co., Santa Cruz Electric, Sun City Water & Sewer, Sun City West Water and Sewer, Southern Union Gas Company, Southwest Gas Company, Tucson Electric Power Company, Continental Telephone Company of California, Continental Telephone of the West and U.S. West Communications, Inc.